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No. 87-984

In the Supreme Court of the United States

OCTOBER TERM, 1987

SHELL OIL COMPANY, APPELLANT

v.

THE IOWA DEPARTMENT OF REVENUE, APPELLEE

On Appeal from the Supreme Court of Iowa

BRIEF FOR THE APPELLANT

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QUESTION PRESENTED

Whether the Outer Continental Shelf Lands Act, 43 U.S.C. §§ 1331 *et seq.*, prohibits states from taxing income earned from the extraction of oil and gas from the outer Continental Shelf.

PARTIES TO THE PROCEEDING AND RULE 28.1 STATEMENT

All of the parties to the appeal of Shell Oil Company in the Supreme Court of Iowa are listed in the caption to this brief. Kelly-Springfield Tire Co. was a party to a separate appeal that was consolidated with the Shell appeal in the Iowa Supreme Court because of an issue, entirely unrelated to the question presented in this Court, that was common to the two appeals below.

Shell Oil Company's parent companies, subsidiaries (excluding wholly-owned subsidiaries), and affiliates are listed at J.S. App. 97a-103a.

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BRIEF FOR THE APPELLANT

OPINIONS BELOW

The opinion of the Supreme Court of Iowa (J.S. App. 1a-14a) is reported at 414 N.W.2d 113. The opinion of the District Court of Polk County (J.S. App. 15a-35a) is not reported.

JURISDICTION

The judgment of the Supreme Court of Iowa was entered on October 21, 1987 (J.S. App. 1a). A notice of appeal to this Court (J.S. App. 92a-93a) was filed on November 23, 1987. The appeal was docketed on December 15, 1987, and the Court noted probable jurisdiction on February 22, 1988 (J.A. 59). The jurisdiction of the Court over this appeal rests on 28 U.S.C. § 1257(2).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The issue in this case is whether the Iowa corporate income tax code, as applied to appellant Shell Oil Company, is invalid under the Supremacy Clause of the United States Constitution (Art. VI, cl. 2) to the extent that it conflicts with the provisions of the Outer Continental Shelf Lands Act ("OCSLA"), 43 U.S.C. §§ 1331 *et seq.* The relevant provisions of the OCSLA and the Iowa corporate income tax code are set forth at J.S. App. 94a-96a.

STATEMENT

This case presents the question whether the Outer Continental Shelf Lands Act ("OCSLA"), 43 U.S.C. §§ 1331 *et seq.*, prohibits states from taxing income earned from the extraction of oil and gas on the outer Continental Shelf ("OCS") pursuant to federal lease.[1] Contrary to the decision below, such taxation is invalid under the OCSLA and the Supremacy Clause because it is inconsistent with the exclusive jurisdiction of the federal government over the OCS, with the explicit language of the OCSLA that state taxation laws "shall not apply" to the OCS, and with the congressional policy of prohibiting state taxes of OCS production in order to enhance the federal government's revenues from lease payments and to promote development of the OCS.

[1] The term "income earned" refers to the portion of income from the sale of OCS oil and gas that is attributable to the extraction of the resource on the OCS. In other words, it is the increment of income that represents the net value at the wellhead (*i.e.*, fair market value less related costs and expenses) of the OCS production. See note 3, *infra*. See also *Atlantic Richfield Co.* v. *Alaska*, 705 P.2d 418 (Alaska 1985), appeal dismissed, 474 U.S. 1043 (1986) (Burger, C.J., and White and Stevens, JJ., dissenting):

> Obviously, profits do not result from * * * oil production until the product is sold. This does not negate the fact that profits generated by the sale are partly attributable to the inherent value of the * * * oil at its point of production.

705 P.2d at 425.

A. The Outer Continental Shelf Lands Act

The outer Continental Shelf is defined as all submerged lands appertaining to the United States that are outside the area three geographical miles (three marine leagues in the case of Florida and Texas) from the coast line of the United States. See 43 U.S.C. §§ 1331(a) and 1301(a)(2). The OCS lies off the shores of the continental United States, Alaska, and Hawaii, and is not located within any of the 50 states. J.S. App. 18a-19a.

Beginning in the 1930s, a dispute developed between the federal government and the states over off-shore lands (both inside and outside the three-mile limit) and the natural resources they contain. In a series of decisions, this Court held that the states were "not the owner of the three-mile marginal belt along [the] coast, and that the Federal Government rather than [a] state has paramount rights in and power over that belt, an incident to which is full dominion over the resources of the soil under that water area, including oil." *United States* v. *California*, 332 U.S. 19, 38-39 (1947); see also *United States* v. *Louisiana*, 339 U.S. 699, 705 (1950) ("[i]f, as we held in California's case, the three-mile belt is in the domain of the Nation rather than that of the separate States, it follows *a fortiori* that

the ocean beyond that limit also is"); *United States* v. *Texas*, 339 U.S. 707 (1950).

In response to these rulings recognizing the paramount rights of the United States in such off-shore areas, Congress in 1953 enacted two statutes. First, in the Submerged Lands Act, 43 U.S.C. §§ 1301-1315, Congress relinquished to the states title to and ownership of the submerged lands and natural resources within the three-mile limit. By that Act "the United States, in effect, quitclaimed to [the states] whatever interest the Federal Government may have had in, and to, all lands and natural resources lying within three geographical miles seaward of the * * * coastline." *United States* v. *California*, 447 U.S. 1, 3 (1980); see also *Secretary of Interior* v. *California*, 464 U.S. 312, 315-316 (1984); *United States* v. *Louisiana*, 363 U.S. 1, 6-7 (1960).

Second, Congress adopted the Outer Continental Shelf Lands Act, 43 U.S.C. §§ 1331-1356. See *Gulf Offshore Co.* v. *Mobil Oil Corp.*, 453 U.S. 473, 479-480 n.7 (1981). The OCSLA declares that the outer Continental Shelf is "subject to [the] jurisdiction [and] control [of the United States]" (43 U.S.C. § 1332(1)) and is "an area of exclusive Federal jurisdiction" (43 U.S.C. § 1333(a)(1)). Accordingly, the "Constitution and laws" of the United States were extended to the OCS (*ibid.*). Moreover, "to fill the substantial 'gaps' in the coverage of federal law, OCSLA borrows the 'applicable and not inconsistent' laws of the adjacent States as surrogate federal law." *Gulf Offshore*, 453 U.S. at 480; see 43 U.S.C. § 1333(a)(2)(A); *Rodrigue* v. *Aetna Casualty & Surety Co.*, 395 U.S. 352, 356-359 (1969). This Court has recognized that the OCSLA

establishes "the exclusive jurisdiction and control of the Federal Government" over the OCS (*Gulf Offshore*, 453 U.S. at 479 n.7).

In addition to providing that the OCS is an area of exclusive federal jurisdiction, the OCSLA specifically addresses the issue of state taxation. Section 1333(a)(2)(A) provides that "State taxation laws shall not apply to the outer Continental Shelf." This prohibition is reinforced by Section 1333(a)(3), which directs that the OCSLA "shall never be interpreted as a basis" for a state to claim "any interest in or jurisdiction * * * over the seabed and subsoil of the outer Continental Shelf, or the property and natural resources thereof or the revenues therefrom."

The OCSLA recognizes that "the outer Continental Shelf is a vital national resource reserve" that "should be made available for expeditious and orderly development" (43 U.S.C. § 1332(3)). In furtherance of that policy, the federal government has established a system of competitive bidding to lease OCS lands for the exploration, development, and production of crude oil, natural gas, and other minerals. See 43 U.S.C. §§ 1334, 1337. Although the Act authorizes several alternatives, a lessee generally pays the government a cash bonus when its bid is accepted, a fixed delay rental during the period prior to production, and a production royalty that is normally one-sixth of the value of production as measured by the volume of production times the industry posted price at the wellhead. See *Watt* v. *Energy Action Educational Foundation*, 454 U.S. 151, 153-154 (1981); J.S. App. 19a. Between 1954 and 1985, the federal government received some $52.7 billion in OCS lease bonus payments, $28.1 billion in royal-

ties, and $0.7 billion in other revenues. U.S. Dep't of the Interior, *Federal Offshore Statistics: 1985*, Tables 2 & 16.

B. Shell's OCS Oil And Gas Activities

Appellant Shell Oil Company is a Delaware corporation with business operations in all 50 states and the District of Columbia. Shell is engaged in the exploration for, and the development, production, transportation, purchasing, and marketing of, crude oil and natural gas, and in the purchase, manufacture, and marketing of oil and chemical products. J.S. App. 16a.[2]

Pursuant to leases obtained from the federal government through competitive bidding, Shell explores for and extracts crude oil and natural gas on the OCS. During the past decade, Shell has paid the government more than $2.2 billion in cash bonuses on Gulf of Mexico and Atlantic federal off-shore leases, $18 million in pre-production rentals, and $2.4 billion in royalties.

Shell controls the disposition of the crude oil and natural gas that it extracts from the OCS. Shell sells all of its gas production to third parties on the Shelf. See *Maryland* v. *Louisiana*, 451 U.S. 725, 730, 731 (1981) (most OCS gas is sold at the wellhead). In contrast, while Shell sells a small portion of its OCS oil on the Shelf, most of its oil production

[2] The factual record in this case was stipulated by the parties, and the facts recited in the lower courts' opinions are based on that stipulation. The relevant portions of the stipulation are reprinted at J.A. 13-50. The facts summarized in this brief relate to calendar years 1975-1980, the tax years in dispute below.

is transferred internally between divisions of Shell on the OCS and is then brought to the mainland, where it is either sold to third parties or refined by Shell for subsequent sale. J.S. App. 17a, 20a; J.A. 31, 34.

The oil and gas extracted from the OCS has a determinable fair market value at the wellhead. The market value of the gas is the actual price at which it is sold to third parties on the Shelf, which is determined by contract in compliance with federal regulations. With respect to OCS oil, Shell determines fair market value based on the industry posted price; Shell uses that market value not only in its corporate accounting system maintained in the ordinary course of business, but also in computing royalty payments to the government pursuant to OCS leases, in establishing depletion allowances under the Internal Revenue Code, and in calculating the federal excise tax on windfall profits. The fair market value of OCS production, less related costs and expenses, represents the income earned from the extraction of oil and gas on the OCS. J.S. App. 17a; J.A. 30-34, 36-37, 43. See note 1, *supra*.[3]

[3] The following example illustrates the concept of OCS income. Suppose Shell produces 1000 barrels of OCS oil; the wellhead value of the oil is $13 per barrel, and the cost of extraction is $10,000. Shell then transports the oil ashore and refines and sells it; the shipping, refining, and marketing costs are $5,000, and the sales price for the refined oil is $25 per barrel. Shell's total net income on the sale of this oil is $10,000 ($25,000 sales price less $15,000 in costs for extraction, shipping, refining, and marketing). Of this amount, $3,000 is the net OCS income ($13,000 in wellhead value less $10,000 in extraction costs), which, we submit, the OCSLA prohibits states from taxing. The remaining $7,000 of income represents the net value added by Shell's transporting,

C. Iowa's Apportioned Tax System

Shell's principal business in Iowa consists of marketing oil and chemical products that it has refined and manufactured. It is not possible to determine whether the products sold in Iowa were derived from OCS or non-OCS oil. J.S. App. 17a-20a, 27a n.1. Shell's operations constitute a "unitary business" substantially similar to that in *Exxon Corp.* v. *Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980). J.S. App. 18a. Because Shell is a unitary business, its corporate income tax in Iowa is determined under the State's apportionment methodology.

Formula apportionment is a recognized method for determining the portion of the aggregate income of a multistate unitary business that is attributable to a given state and thus taxable by that state. "[N]et income from all sources [not allocated to a specific situs], whether within or without the State, includable in the tax base * * * becomes the apportionable base to which the formula is applied." J. Hellerstein, *State Taxation* ¶ 9.1 at 478 (1983). See, *e.g.*, *Container Corp.* v. *Franchise Tax Bd.*, 463 U.S. 159, 165-166, 169 (1983); *Exxon Corp.*, 447 U.S. at 219-220. More than 40 states and the District of Columbia currently use formula apportionment to tax the income of multistate unitary businesses, and under Iowa's reading of the OCSLA each of these jurisdictions would be free to tax Shell's OCS income by including it in the apportionable income base. But see Ky. Rev. Pol. 41P130, [1 Ky.] St. Tax Rep. (CCH) ¶ 16-022 (agreeing with our position that the OCSLA prohibits apportioned state taxation of OCS income).

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refining, and marketing the oil, which states may tax because such non-OCS income is outside the OCSLA prohibition.

Section 422.33 of the Iowa Tax Code applies a one-factor apportionment formula based on sales inside and outside the State. See *Moorman Manufacturing Co.* v. *Bair*, 437 U.S. 267 (1978). As described by the Iowa District Court (J.S. App. 26a-27a):

> The formula for calculating that portion of a multistate corporation's income subject to Iowa income tax under the one factor formula is as follows:

$$\left(\frac{\text{Iowa Gross Sales}}{\text{Everywhere Gross Sales}}\right) \times \left(\begin{array}{c}\text{Federal Taxable Income}\\ \text{Adjusted Per Iowa Law}\end{array}\right) = \text{Iowa Income}$$

At issue in this case is the proper determination of the income base (*i.e.*, the adjusted "Federal Taxable Income" component above) to which the apportionment factor is to be applied to calculate Iowa income.[4] Shell submits that the OCSLA prohibits states from taxing the income earned from oil and gas that it extracted from the OCS and therefore that the net wellhead value of that production must be excluded from the income base that is apportionable among the states.[5]

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[4] In contrast to Iowa, most other apportionment jurisdictions utilize some form of three-factor formula based on payroll, property, and sales. The difference between the one-factor and three-factor methodologies does not affect the question presented in this appeal: what is to be included in the income base that is subject to apportionment.

[5] In equation form, Shell contends that the apportionable income base is:

$$\left(\begin{array}{c}\text{Federal Taxable Income}\\ \text{Adjusted Per Iowa Law}\end{array}\right) - \left(\begin{array}{c}\text{Income Earned From}\\ \text{OCS Production}\end{array}\right) = \begin{array}{c}\text{Non-OCS}\\ \text{Taxable Income}\end{array}$$

D. The Proceedings Below

This appeal involves Shell's Iowa taxes for the years 1978-1980.[6] The Iowa Department of Revenue issued a Notice of Assessment to Shell based on the inclusion of Shell's OCS income in the apportionable tax base.[7]

Because, for consistency, the apportionment factor also would have to be adjusted for OCS sales, Shell's income taxable in Iowa would be (J.S. App. 27a):

$$\left(\frac{\text{Iowa Gross Sales}}{\text{Everywhere Gross Sales} - \text{OCS Gross Sales}}\right) \times \left(\text{Non-OCS Taxable Income}\right) = \text{Iowa Income}$$

[6] In the courts below, Shell's OCS argument also encompassed the tax years 1975-1977, but the Iowa Supreme Court's decision on unrelated state-law grounds (J.S. App. 2a-7a) has now resolved those earlier years in Shell's favor.

[7] The amounts in dispute due to the OCS issue were as follows:

	Income Apportioned To Iowa		Difference In Tax On Account Of OCS Issue	
Year	Department Method ($)	Shell Method ($)	Increase (Decrease) In Tax Per Assessment ($)	Increase (Decrease) In Tax Per Assessment (%)
1975	3,457,254	3,043,554	41,369	13.7%
1976	4,473,053	3,847,942	62,511	16.3%
1977	3,741,663	3,506,061	23,460	6.7%
1978	3,698,792	3,784,909	(8,612)	(2.3)%
1979	5,584,753	4,868,861	71,590	14.8%
1980	4,671,395	3,813,008	85,839	22.7%

See J.A. 51-56. As tax year 1978 illustrates, it is possible for Shell's interpretation of the OCSLA to result in *higher* state taxes.

After the Department of Revenue rejected Shell's administrative protest (J.S. App. 36a-38a, 39a-91a), Shell sought judicial review in the Iowa District Court for Polk County. That court sustained the Department's inclusion of OCS income in the apportionable base, holding that the OCSLA does not prevent states "from indirectly taxing some portion of OCS activities pursuant to a constitutionally permissible apportionment scheme related to [the taxpayer's] sales in the taxing state" (*id.* at 31a).

The Iowa Supreme Court affirmed this ruling. J.S. App. 7a-14a. Based on the legislative history of the OCSLA, the court below construed "the language restricting the application of state taxation laws to the OCS and denying to the state any interest in the natural resources or revenues from the seabed and subsoil of the OCS [to be] intended as a limitation on the authority of states adjacent to OCS lands to extend legislative jurisdiction to the OCS" (*id.* at 10a). Given this construction, the court held that the OCSLA does not bar Iowa's taxation of Shell's OCS income (*id.* at 11a):

> [Iowa's tax] is in no way dependent upon the exercise of legislative jurisdiction on OCS lands. Its taxing jurisdiction depends instead on the nexus of Shell's activities within this state. The inclusion of some OCS revenues in the apportionment formula is simply a method of obtaining an acceptable measure of the local nexus.

The Iowa Supreme Court made clear that the State could include in the tax base Shell's earnings from *all* OCS oil and gas, whether Shell's sales of those OCS products to third parties occurred on or off the Shelf (J.S. App. 10a). The court below thus disagreed with

Shell Oil Co. v. *Department of Revenue*, 496 So.2d 789 (Fla. 1986), appeal pending, No. 86-1593 (U.S. filed Mar. 20, 1987), in which Florida conceded that the OCSLA requires income from on-Shelf sales to be excluded from apportionment.[8] Under the Iowa Supreme Court's decision, therefore, every state can tax an apportioned share of Shell's OCS income from sales on as well as off the outer Continental Shelf.

SUMMARY OF ARGUMENT

By including Shell's OCS income in the earnings base that is apportioned among the states, Iowa imposes a tax on a pro rata share of the income attributable to Shell's extraction of oil and gas from the outer Continental Shelf. We do not contest Iowa's constitutional authority under the Due Process and Commerce Clauses to apply its apportionment methodology in this manner. Rather, such taxation of OCS income

[8] In that case, a divided Florida Supreme Court upheld the State's apportioned taxation of OCS income derived from sales that occurred off the Shelf. The dissenting justices concluded that "Florida's corporate income tax law directly conflicts with federal law specifically prohibiting the application of state taxes to the outer Continental Shelf," which "Congress intended to limit state taxation power over revenues generated from drilling on the outer Continental Shelf regardless of where the sale of the oil takes place" (Shell *Florida* J.S. App. 1-18 to 1-19). Recognizing that the purpose of the OCSLA was "to give the federal government exclusive control over the development and production of [OCS resources]" (*id.* at 1-26) and that Florida's tax would mean "less [of an] incentive for companies to explore and produce oil" (*id.* at 1-34), the dissent would have held that the OCSLA "prohibits the imposition of any state tax"—whether "direct" or "indirect"—"on revenues derived [from the OCS]" (*id.* at 1-28).

runs afoul of a federal statute—the Outer Continental Shelf Lands Act. In enacting the OCSLA, Congress, as it has done in a variety of other contexts, prohibited state taxes on certain income in order to promote paramount national policies. Iowa's attempt to defend its tax on Shell's OCS income rests on a series of arguments that are unsupported by the text or history of the OCSLA and are utterly divorced from the policies of the Act.

First, Iowa asserts that apportioned income taxes constitute a unique exception to the OCSLA state tax prohibition, which, by the State's own admission, bans *all* other forms of taxation of OCS oil and gas production. Nothing in the statute, however, so much as hints at such a singular exemption for these taxes. On the contrary, the state tax prohibition is absolute and categorical: "State taxation laws," without restriction, "shall not apply" to OCS income and activities (43 U.S.C. § 1333(a)(2)(A)), and states "shall never" under the OCSLA have "any interest in or jurisdiction * * * over * * * revenues" from the OCS (43 U.S.C. § 1333(a)(3)).

Nor does the legislative history contain any suggestion that Congress intended a special rule for apportioned taxes, despite the fact that they were commonly utilized by the states and had long been in existence at the time the OCSLA was enacted. Quite the opposite, the legislative record in general, and the understanding of Senator Long in particular, clearly indicates that apportioned income taxes were subject to the state tax prohibition. Time and again, Congress rejected proposals to allow states to tax OCS oil and gas, and it fully appreciated the encompassing and unqualified scope of the provision that it adopted.

Second, Iowa's taxation of OCS income is irreconcilable with the congressional purposes underlying the OCSLA. The state tax prohibition was intended to provide an incentive for oil companies to participate in exploration and production on the Shelf, thereby both enhancing the revenues that the government would receive from the OCS leasing program and promoting the prompt development of this important energy resource for our Nation. Congress has subsequently reiterated and re-emphasized these fundamental OCS policies, which have been given increased importance by the budgetary and energy problems that have faced the country during the last two decades. Apportioned taxation of OCS income interferes with the achievement of Congress's overriding objectives in the OCSLA. See *Maryland* v. *Louisiana*, 451 U.S. 725, 753 n.26 (1981) (state taxation "would adversely affect the price which the Government could command from private developers in their bid price.")

Third, the OCSLA state tax prohibition does not, as Iowa contends, merely duplicate the established constitutional proscription of extraterritorial state taxation. The State's reading cannot be squared with the lengthy and controversial debates over the provision, which show that Congress intended the Act to be a meaningful limitation on state taxes and not a pointless repetition of existing legal principles. Moreover, the policies of the OCSLA are no less infringed by a tax that the state constitutionally has jurisdiction to impose. Iowa has not advanced any reason to gut this central statutory provision by treating it as empty surplusage.

Fourth, Iowa's position simply makes no legal or practical sense. By arguing that each state is free to

tax a proportionate part of Shell's OCS income, Iowa would allow the states collectively to do what it concedes no state can do individually: levy an income tax on the full measure of Shell's OCS production. The practical consequences of these two methods of taxation are the same for—and are equally detrimental to—the dual OCSLA policies of augmenting federal revenues and promoting OCS development. It is impossible to conclude that Congress, without a word in the statute or legislative history to that effect, would have intended to prohibit an unapportioned corporate income tax yet to permit the states cumulatively to impose the same economic burden through the device of an apportioned income tax.

Since the enactment of the OCSLA 35 years ago, the states have been unhappy about the Act's restriction on their taxing power. Iowa's position in this case is the latest example of that longstanding dissatisfaction in the specific context of apportioned income taxes. While Congress has carefully considered the states' contentions, it has consistently adhered to the prohibition on state taxation of OCS income and activities. Congress likewise has waived constitutional or statutory immunities from state taxation in a number of other areas, but it has never been persuaded to do so in the OCSLA. It should be left to Congress to resolve the states' objections to the OCSLA statutory scheme.

ARGUMENT

THE OUTER CONTINENTAL SHELF LANDS ACT PROHIBITS STATES FROM TAXING INCOME EARNED FROM THE TAXPAYER'S EXTRACTION OF OIL AND GAS ON THE OUTER CONTINENTAL SHELF

The question presented in this case is whether the Outer Continental Shelf Lands Act permits states to tax the income earned from the taxpayer's extraction of oil and gas from a federal enclave (the OCS) pursuant to federal lease. Unlike most state income tax cases that the Court has decided, this case does not involve a constitutional challenge to the validity of the apportionment formula used to prorate among the states the aggregate income of a multistate unitary business. Instead, it presents the antecedent question of what, as a matter of statutory interpretation, may be included in the income base that is subject to apportionment.

As we show below, the OCSLA requires states to exclude OCS oil and gas income from apportioned taxation. In a number of other instances, Congress has determined that significant federal interests warrant granting an immunity from state tax laws. So too, here, Congress has concluded that state taxation of income attributable to production on the outer Continental Shelf would hinder paramount federal policies in that exclusively federal domain.[9]

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[9] This case relates only to taxation of the income earned from the extraction of oil and gas on the OCS. See notes 1, 3, *supra*. States are free, ~~of course~~, to tax the portion of a taxpayer's income that is attributable to the subsequent transporting, processing, and marketing of OCS production.

A. Congress Has The Settled Power To Immunize Income From State Taxation In Order To Promote Federal Policies

To place the OCSLA in its broader context, we begin with a brief overview of Congress's authority to prohibit or limit state taxation in order to promote federal policies and protect national interests from state interference. As one leading commentator has explained, "the power of Congress to control state and local taxation, regarding federal immunity from taxation, has consistently been sanctioned by the [Supreme] Court." P. Hartman, *Federal Limitations on State and Local Taxation* § 6:5 at 248 (1981). Moreover, "[u]nder its power, Congress can * * * grant immunity to *private* parties having business relations with the Federal Government" (*ibid.* (emphasis in original)). Thus, there can be no doubt that Congress "has the power to confer upon otherwise taxable entities, having a business relationship with the Federal Government, the tax-exempt status of a federal instrumentality" (*id.*, § 6:9 at 260).

On a number of occasions, Congress has exercised this authority to create an immunity from state taxation. Perhaps the best-known illustration is 31 U.S.C. § 3124(a), which prohibits states from taxing dividend and interest income derived from federal securities. See, *e.g.*, *American Bank & Trust Co.* v. *Dallas County*, 463 U.S. 855 (1983).[10] Section 3124(a) immunizes such income from otherwise applicable state

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[10] Similar prohibitions are contained in 12 U.S.C. § 1433 (Federal Home Loan Bank), 12 U.S.C. § 1725(a) (Federal Savings and Loan Insurance Corporation), and 12 U.S.C. §§ 2055, 2079, and 2134 (Federal land banks, Federal intermediate credit banks, and Federal banks for cooperatives).

levies "to prevent taxes which diminish in the slightest degree the market value or the investment attractiveness of obligations issued by the United States in an effort to secure necessary credit." *Smith* v. *Davis*, 323 U.S. 111, 117 (1944). Iowa and other states have recognized, as they must, that Section 3124(a) prohibits the inclusion of federal securities income in a corporation's apportionable tax base, since such inclusion would enable each state to tax an apportioned share of income that Congress has put entirely beyond the states' reach. See Iowa Code Ann. § 422.35(1) (West 1971); *Continental Illinois Nat'l Bank* v. *Lenckos*, 102 Ill. 2d 210, 220-225, 464 N.E.2d 1064, 1069-1071, cert. denied, 469 U.S. 918 (1984); *First Fed. Sav. & Loan* v. *Dept. of Revenue*, 200 Mont. 358, 654 P.2d 496, 497-499 (1982), cert. denied, 462 U.S. 1144 (1983); *Federal Products Corp.* v. *Norberg*, 429 A.2d 447, 448, 449 & n.2 (R.I. 1981); *SmithKline Beckman Corp.* v. *Commonwealth*, 85 Pa. Commw. 437, 482 A.2d 1344 (1984), aff'd, 508 Pa. 359, 498 A.2d 374 (1985).

In a variety of other statutes, Congress has likewise enacted federal limitations on state taxation. For example, 49 U.S.C. § 1513(a) bars enumerated state taxes on airline gross receipts. As this Court explained in *Aloha Airlines, Inc.* v. *Director of Taxation*, 464 U.S. 7, 9 (1983), the federal government obtains substantial revenues for the Airport and Airway Trust Fund from the taxation of airline services, and Section 1513(a) preserves that source of federal revenues from the "impos[ition of] double taxation" by the states. In addition, Congress has established an "immunity from taxation" (*Lawrence* v. *Shaw*, 300 U.S. 245, 250 (1937)) for benefit payments to veterans. See 38 U.S.C. § 3101(a); *Porter* v. *Aetna*

Casualty & Sur. Co., 370 U.S. 159 (1962). Similarly, 50 U.S.C. App. § 574 precludes state income or personal property taxes on non-resident military personnel who are stationed in the state. See *Dameron* v. *Brodhead*, 345 U.S. 322 (1953). And 15 U.S.C. § 381 prohibits a state from taxing income derived within the state if the taxpayer's only in-state business activities involve the solicitation of orders. See *Heublein, Inc.* v. *South Carolina Tax Comm'n*, 409 U.S. 275 (1972). See also 15 U.S.C. § 391 and *Arizona Public Service Co.* v. *Snead*, 441 U.S. 141 (1979) (prohibition on state tax that discriminates against out-of-state manufacturers or consumers of electricity); 49 U.S.C. § 11503 and *Burlington Northern R.R.* v. *Oklahoma Tax Comm'n*, 107 S. Ct. 1855 (1987) (prohibition on discriminatory state taxation of railroads); 49 U.S.C. § 1513(d) (prohibition on discriminatory state taxation of air carriers).

Congress may of course amend the OCSLA if it becomes persuaded that, as a matter of federal policy, states should be allowed to tax OCS oil and gas income. Indeed, as this Court noted in *Garcia* v. *San Antonio Metro. Transit Auth.*, 469 U.S. 528, 552, 556 (1985), "[t]he effectiveness of the federal political process in preserving the States' interests is apparent," given the role that "our system provides [for] state participation in federal governmental action." In the past, Congress has seen fit to rescind state tax immunities that it previously enacted. See, *e.g.*, Hartman, *supra*, § 6:15 at 312-313 (Congress repealed, "as a result of protests by affected States," statutory tax immunity for federal contractors under the Atomic Energy Act). In addition, Congress in several statutes has waived constitutional protections

against state taxes.[11] But unless and until Congress takes such action here, the OCSLA stands as a barrier to state taxation of OCS income. If Iowa and other states are dissatisfied with the OCSLA scheme, it is to Congress, not this Court, that they should turn. See *Laborers Health & Welfare Trust Fund* v. *Advanced Lightweight Concrete Co.*, 108 S. Ct. 830, 837 (1988); *United States* v. *New Mexico*, 455 U.S. 720, 744 (1982).

B. Iowa's Apportioned Taxation Of Shell's OCS-Oil And Gas Income Violates The OCSLA

In its motion to dismiss (at 13), Iowa concedes that the OCSLA prohibits a wide range of state taxes on OCS income and activities. As Iowa recognizes, "any attempt by a state to impose a severance tax upon OCS production, a sales tax upon OCS wellhead sales, or a property tax upon OCS property would be clearly prohibited." Iowa also acknowledges that "a state unapportioned income tax levied upon income-generating activities in the OCS would be proscribed."

Although admitting that no state may levy a direct income tax on OCS income, Iowa argues that it

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[11] See, *e.g.*, the Buck Act, 4 U.S.C. §§ 105 *et seq.* (discussed at pages 27-28, *infra*); the Mineral Leasing Act, 30 U.S.C. § 189, and *Mid-Northern Oil Co.* v. *Walker*, 268 U.S. 45 (1925) (discussed at page 27, *infra*); 16 U.S.C. § 480 and *Wilson* v. *Cook*, 327 U.S. 474 (1946) (states have jurisdiction to impose tax in national forest); 26 U.S.C. § 3305 (states may impose unemployment tax on, *e.g.*, persons performing services on federal property); 40 U.S.C. § 290 (states may apply workers' compensation laws to federal property); *Offutt Housing Co.* v. *Sarpy County*, 351 U.S. 253 (1956) (state taxation of Air Force housing on federal property pursuant to military leasing and housing acts).

and each of the other states in which Shell does business are entirely free to impose an income tax on a pro rata share of Shell's OCS income by including that income in the apportioned tax base. Under Iowa's theory, apportioned state income taxes—alone among all state taxes—are exempt from the state tax prohibition in the OCSLA.

On its face, Iowa's submission is highly doubtful. The OCSLA and its legislative history do not contain any exception for apportioned state income taxes. Nor are such taxes compatible with the policies underlying the Act. In terms of the statutory language, history, and purpose, there is no legal or practical difference between one state directly imposing an unapportioned income tax on OCS income—which Iowa concedes would be invalid—and each of several states taxing an apportioned share of that same income. It is the economic substance of the state tax that matters, not the theoretical justification for the exaction.

To illustrate the incongruity of the State's argument, consider Iowa's apportioned taxation of Shell's OCS oil income, and assume for the sake of simplicity that Shell does business and sells its OCS oil only in that State. Because no third-party sales of oil occur on the Shelf, 100% of Shell's OCS oil income would be apportioned to—and taxed by—Iowa under its sales-factor apportionment formula. We fail to see any meaningful distinction between that tax and an income tax levied directly on Shell's OCS income by Louisiana, Texas, or Florida, which the legislative history makes clear, and Iowa itself agrees, the OCSLA prohibits. Simply stated, Iowa's position would permit the states to "do indirectly that which [they are] prohibited from doing di-

rectly." *Continental Illinois*, 102 Ill. 2d at 223, 464 N.E.2d at 1070.

It may be helpful in this regard to imagine a corporation whose offshore oil and gas operations are conducted by a separate subsidiary that does business only on the outer Continental Shelf. What Congress has done in the OCSLA is, in effect, to immunize the income of that subsidiary, doing business solely within a federal enclave, from state taxation. In other words, the states are prohibited from including the net income of the OCS subsidiary in the parent corporation's income base for purposes of apportioned taxation. Iowa's taxing scheme plainly runs afoul of that requirement.

Iowa nonetheless seeks to justify its anomalous position by asserting that—even though OCS income unquestionably is included in the apportionable tax base that is used to determine the taxable income for each state—its apportionment methodology does not "tax[] a portion of [Shell's OCS] earned income" (Mot. to Dis. 10). In the State's view, its apportioned state income tax "does not inherently tax OCS activities, merely because OCS revenues and expenses are included within the apportionment" (*id.* at 13).

Iowa's characterization of apportioned taxation is simply incorrect. Contrary to the State's assertion, apportionment does result in a tax on Shell's OCS income. Moreover, such taxation is squarely prohibited by the OCSLA.

1. ***Iowa's Apportionment Methodology Taxes Shell's OCS Income***

Iowa's income tax indisputably imposes a levy on the income Shell earned from the extraction of oil

and gas from the OCS pursuant to federal lease. That income, by virtue of its inclusion in Shell's apportionable income from sales of OCS oil and gas, is reflected in Iowa's pro rata share of income that is the basis for computing Shell's tax liability to the State.

Indeed, the very theory of apportioned taxation demonstrates that Iowa is taxing Shell's OCS income. Under formula apportionment, "all the apportionable net income from a multistate business is first determined, and it is then apportioned according to the relevant formula to the particular State." Hartman, *supra*, § 9:18 at 523. In this way, " 'the entire net income of a corporation * * * [is] apportioned among the States for tax purposes.' " *Exxon Corp.* v. *Wisconsin Dept. of Revenue*, 447 U.S. 207, 219 (1980) (citation omitted). Given this division of total income, it is clear, as this Court has recognized, that apportionment "subject[s] to taxation * * * income derived from the extraction of oil and gas located outside the State" (*id.* at 210). See also *Moorman Manufacturing Co.* v. *Bair*, 437 U.S. 267, 272 (1978) (apportionment "may result in taxation of some income that did not have its source in the taxing State"); *Mobil Oil Corp.* v. *Vermont Comm'r of Taxes*, 445 U.S. 425, 440 (1980) (apportionment "include[s] income earned from [taxable events that occur outside the state] in the preapportionment tax base"); J. Hellerstein, *State Taxation* ¶ 9.1 at 478 n.1 (1983) (citation omitted) (" '[i]n * * * apportionment, the taxpayer's normal or business income is mathematically divided among the various jurisdictions in which it does business to determine the measure of local tax' ").[12]

[12] The Iowa District Court acknowledged that Iowa and other apportionment states were "indirectly taxing some por-

Moreover, this conclusion is confirmed by the evidence in this case. In each of the tax years reflected in the record (see page 10, note 7, *supra*), Iowa's inclusion of Shell's OCS operations in its apportionment methodology affected the amount of Shell's income that was taxable by the State. And in all but one of those years, inclusion of Shell's OCS activities increased the tax due the State. Thus, Shell's OCS income is clearly encompassed in the income that Iowa is taxing.

In sum, Iowa—and each of the more than 40 other states that have an apportioned corporate income tax (except Kentucky, see page 8, *supra*)—claims the right to tax an allotted portion of Shell's OCS income by attributing a percentage of that income to Shell's transactions that occur in the State. While Iowa may have the constitutional power to value in-state transactions under that apportionment theory, there can be no doubt that in doing so the State has taxed Shell's OCS income. The question presented here is whether such taxation is consistent with the OCSLA. As demonstrated by the text, history, and policies of the Act, the answer to that question is "no."

2. *The Plain Language Of The OCSLA Prohibits Iowa's Tax On Shell's OCS Oil And Gas Income*

"The starting point in statutory interpretation is 'the language of the statute itself.'" *United States* v. *James*, 106 S. Ct. 3116, 3121 (1986) (citation omitted). That language "'must ordinarily be regarded as conclusive'" absent a "'clearly expressed legislative intention to the contrary.'" *Id.* at 3122 (citation omitted). Here, the plain language of the OCSLA prohibits Iowa from taxing Shell's earnings from the extraction of oil and gas from the OCS.

tion of [Shell's] OCS activities" (J.S. App. 31a). However, it erroneously believed that such taxation was not inconsistent with the OCSLA because it occurred "pursuant to a constitutionally permissible apportionment scheme related to Shell's sales in the taxing state" (*ibid.*).

By its express terms, the OCSLA asserts the "jurisdiction" and "control" of the United States over the OCS (43 U.S.C. § 1332(1)) as a "vital national resource reserve" that "should be made available for expeditious * * * development" (43 U.S.C. § 1332 (3)). Accordingly, in extending the Constitution and laws of the United States to the Shelf, the Act provides that the OCS is "an area of exclusive Federal jurisdiction" (43 U.S.C. § 1333(a)(1)).

Under settled principles, states cannot impose a tax on private property or persons within an area of exclusive federal jurisdiction, absent the consent of Congress. Exclusive federal jurisdiction "is in essence complete sovereignty. That is, not only is the federal property immune from taxation because of the supremacy of the Federal Government but state laws, not adopted directly or impliedly by the United States, are ineffective to tax or regulate other property or persons upon that enclave." *S.R.A., Inc.* v. *Minnesota*, 327 U.S. 558, 562-563 (1946). Thus, "[w]herever the United States has such jurisdiction the State would have no authority to lay the tax." *James* v. *Dravo Contracting Co.*, 302 U.S. 134, 140 (1937). In *Humble Pipe Line Co.* v. *Waggonner*, 376 U.S. 369 (1964), for example, the Court applied these principles to hold that the state could not tax a private party who had leased land in an exclusive federal enclave to develop oil and gas reserves. Similarly, in *Ramah Navajo School Bd.* v.

New Mexico Bureau of Revenue, 458 U.S. 832 (1982), the Court held that the state could not impose a gross receipts tax on a non-Indian construction company engaged in building a school on an Indian reservation. See also *White Mountain Apache Tribe* v. *Bracker*, 448 U.S. 136 (1980), discussed at page 37, note 45, *infra*.

Given the explicit provision in Section 1333(a)(1) that the outer Continental Shelf is an area of exclusive federal jurisdiction, this analysis normally would be sufficient to prevent state taxation based on OCS activities. However, because 43 U.S.C. § 1333(a)(2)(A) incorporates certain state laws as surrogate federal law applicable to the OCS (see page 4, *supra*), Congress could not rest with the general preemptive implications of exclusive federal jurisdiction. Instead, it affirmatively exercised its plenary authority over federal property (see, *e.g.*, *Kleppe* v. *New Mexico*, 426 U.S. 529, 540-546 (1976)) to enact two additional provisions that confirm the invalidity of state taxation of income earned from the extraction of OCS oil and gas.

First, in language that is noteworthy for its clarity and directness, Congress declared: "State taxation laws shall not apply to the outer Continental Shelf" (43 U.S.C. § 1333(a)(2)(A)). It is hard to imagine simpler or more sweeping language to prohibit state taxation of the income attributable to the production of oil and gas on the Shelf.

Second, Congress provided that the OCSLA "shall never be interpreted" as a basis for a state to claim "any interest in or jurisdiction * * * over * * * the revenues" from the OCS (43 U.S.C. § 1333(a)(3)). This emphatic prohibition precludes Iowa not only

from asserting jurisdiction over the OCS but also from claiming "any interest in" Shell's apportioned "revenues" from OCS oil and gas.

Other provisions of the OCSLA confirm the view that state taxation of OCS activities is impermissible. For example, the Mineral Leasing Act of 1920, 30 U.S.C. § 189, expressly allows states "to levy and collect taxes upon * * * any lessee of the United States." See *Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609, 631-632 (1981). However, Congress chose to make the Mineral Leasing Act inapplicable to the OCS by providing that "mineral leases on the outer Continental Shelf shall be maintained or issued only under the provisions of [the OCSLA]" (43 U.S.C. § 1333(a)(1)).

Significantly, Congress also did not extend the Buck Act to the OCS. The Buck Act of 1940, 4 U.S.C. §§ 105-110, constitutes congressional authorization for states to impose specified taxes on people or property in federal areas. See *United States* v. *Mississippi Tax Comm'n*, 421 U.S. 599, 603, 611 (1975). In particular, 4 U.S.C. § 106 provides that a state shall have "full jurisdiction and power to levy and collect" income taxes in any federal area within the state, and that "[n]o person shall be relieved from liability for any income tax levied by any State * * * by reason of his * * * receiving income from transactions occurring or services performed" in a federal area. However, because the Buck Act is restricted to federal areas "located within the exterior boundaries" of a state (4 U.S.C. § 110(e)), it is inapplicable to the OCS. The failure of the OCSLA to incorporate the Buck Act's specific authorization for state income taxes is telling evidence that rein-

forces the conclusion that states may not tax the income Shell earned from the extraction of OCS oil and gas.

3. *The Legislative History And Policies Of The OCSLA Preclude Iowa's Tax On Shell's OCS Oil And Gas Income*

Where, as here, the express provisions of a federal statute prohibit a state tax, it is unnecessary for courts to look behind the statute to consider the legislative history and congressional policies underlying the prohibition. See, *e.g.*, *Aloha Airlines*, 464 U.S. at 12. In any event, the history and purposes of the OCSLA further demonstrate that Iowa's tax on Shell's OCS oil and gas income is invalid.

a. *The 1953 OCSLA Statute*

i. The OCSLA was originally enacted in 1953. The legislative history of that statute is extensive, involving a number of separate bills introduced and debated over several Congresses. But for present purposes, one feature of this history stands out: the states made repeated attempts to obtain tax or lease revenues from the OCS, which Congress consistently rejected in order to preserve exclusive federal jurisdiction over, and exclusive federal revenues from, the OCS.

Numerous proposals were introduced in Congress to enable states to share directly or indirectly in the wealth of the OCS. These included proposals: to extend state police powers, including the taxing power, to the OCS;[13] to permit the states to impose

[13] See H.R. Rep. No. 695, 82d Cong., 1st Sess. 7, 13 (1951); *Outer Continental Shelf: Hearings on S. 1901 Before the Senate Comm. on Interior and Insular Affairs*, 83d Cong., 1st Sess. 471 (1953).

severance or production taxes but to exclude all other forms of taxation;[14] to apply the Mineral Leasing Act to the OCS, which would have allowed the states to levy taxes (see page 27, *supra*);[15] to provide states with a portion of the royalties paid to the United States for OCS leases;[16] to establish a joint congressional committee to determine federal reimbursement to the states for services provided to OCS lessees and their employees;[17] and to use the proceeds of OCS leases for grants to public education, which would have redounded largely to the financial benefit of the states.[18]

All of these proposals rested on two basic arguments. First, states contended that it was unfair to treat them differently under the OCSLA than under the Mineral Leasing Act, which authorized states to tax and gave them a portion of the federal revenues from lease and royalty payments. Second, states argued that development of the OCS would result in increased costs for on-shore state services that should in fairness be funded by OCS taxes or revenues.[19] In

[14] See H.R. Rep. No. 215, 83d Cong., 1st Sess. 7-8 (1953).

[15] See S. Rep. No. 411, 83d Cong., 1st Sess. 27, 37 (1953); 99 Cong. Rec. 6966 (1953) (remarks of Sen. Cordon).

[16] See S. Rep. No. 411 at 3.

[17] See 99 Cong. Rec. 7251-7255 (1953).

[18] See S. Rep. No. 411 at 2-3.

[19] See S. Rep. No. 411 at 3; *id.* at 65-68 (minority report); 99 Cong. Rec. at 2505 (remarks of Rep. Willis); *id.* at 2510 (remarks of Rep. Wilson); *id.* at 2548 (remarks of Rep. Thompson); *id.* at 4887 (remarks of Rep. Wilson); *id.* at 7226-7227, 7228 (remarks of Sen. Ellender); *id.* at 7231, 7251, 7252 (remarks of Sen. Long); *id.* at 7259 (remarks of Sen. Daniel); *id.* at 7260-7263 (remarks of Sen. Long).

the end, however, Congress was unpersuaded by the states' arguments and defeated all of their proposals. Both the House bill (whose language was incorporated in 43 U.S.C. § 1333(a)(2)(A)) and the Senate bill (whose language was incorporated in 43 U.S.C. § 1333(a)(3)) were in agreement that the states were not entitled to *any* part of the tax or lease revenues from the OCS.[20]

ii. The power of the states to tax OCS activities was repeatedly discussed and emphatically denied by Congress. For example, the Senate Report on the OCSLA explained that state taxation laws "necessarily are excluded" from the OCS, a proposition that Section 1333(a)(3) made "plain" in "precise unequivocal language."[21] Similarly, Representative Keating, in introducing the amendment to the House bill that eventually was enacted as the state tax prohibition in Section 1333(a)(2)(A), referred to the position of the Secretary of the Interior that states "should have no taxing power whatsoever on the outer Continental Shelf" and "should be given nothing from the resources."[22] In the words of the Conference Report, "State taxation laws are specifically banned."[23]

Congress well understood the absolute and sweeping nature of the prohibition on state taxes. Representative Boggs, in a colloquy with Representative Keating, explained that the Keating amendment

[20] See H.R. Conf. Rep. No. 1031, 83d Cong., 1st Sess. 12 (1953).

[21] See S. Rep. No. 411 at 3, 23, 11.

[22] 99 Cong. Rec. at 2572.

[23] H.R. Conf. Rep. No. 1031 at 12.

"strikes out any participation by the States in the taxing of these resources."[24] Likewise, Representative Brooks observed that OCS lessees would be "immune to State and local laws as far as taxes are concerned."[25] And Representative Willis noted that "taxing powers" were "completely denied to the States."[26] The Senate debates equally reflected that "the sole jurisdiction, control, and right to tax *in any form* is in the United States"[27] and that states would not be permitted to "tax[] private lessees engaged in operations on the outer shelf."[28]

With respect to the specific question presented in this case, the most pertinent portions of the legislative history are the statements of Senator Long of Louisiana, who was a member of the Senate Committee that considered the OCSLA and whose state was intensely interested in the taxing and revenue provisions in the statute. Senator Long correctly perceived the restrictions on state taxing power that are controlling here. In particular, noting in the Senate Report that the Act "den[ied] the States any power of taxation,"[29] Senator Long recognized that OCS lessees would be "subject neither to the State's severance tax, property tax, *nor the tax on corporate profits*."[30] He later reiterated these points on the

[24] 99 Cong. Rec. at 2572.

[25] *Id.* at 2577.

[26] *Id.* at 4883.

[27] *Id.* at 7234 (remarks of Sen. Cordon) (emphasis added).

[28] *Id.* at 7259 (remarks of Sen. Daniel).

[29] S. Rep. No. 411 at 65 (minority report).

[30] *Id.* at 67 (emphasis added).

floor, adding that OCS lessees "are beyond the reach of the State." [31] At no time in the legislative debates on the OCSLA did anyone express disagreement with Senator Long or correct his understanding of the Act.

Thus, Senator Long expressly acknowledged that the OCSLA would prohibit state taxation of OCS income. At the same time, Senator Long understood that OCS development would require lessees to have substantial on-shore operations, which could be taxed by the states.[32] In light of that taxable activity, it is quite clear that Senator Long's construction of the OCSLA state tax prohibition was directed at state income taxes on the profits from OCS oil and gas production.

It is, in addition, of particular significance here that Louisiana in fact had an apportioned corporate income tax in 1953.[33] Senator Long undoubtedly was aware of that tax, which Louisiana had first enacted in the 1930s. Therefore, Senator Long's unqualified conclusion that OCS income was not "subject * * * to * * * the tax on corporate profits" and was "beyond the reach of the State" clearly establishes that such income could not be taxed under a state apportionment methodology.

Indeed, of the 36 states and territories (including the District of Columbia, Alaska, and Hawaii) that had a corporate income tax in 1953, *all of them* ap-

[31] 99 Cong. Rec. at 7260-7261.

[32] See S. Rep. No. 411 at 67 (minority report); 99 Cong. Rec. at 7261 (remarks of Sen. Long).

[33] See G. Altman & F. Keesling, *Allocation of Income in State Taxation* 17-18, 143-144, 166-168 (2d ed. 1950).

pear to have used formula apportionment to tax multistate unitary businesses.[34] As early as 1921, the National Tax Association had prepared a model bill for the apportionment of business income,[35] and by 1939 all but one of the 32 jurisdictions with a corporate income tax apportioned the income of interstate companies.[36] And, as Iowa pointed out in its motion to dismiss (at 7 n.7), this Court had "firmly established" the constitutionality of formula apportionment in a series of decisions beginning in 1920. Yet against this background, there is nothing in the text of the OCSLA that exempts apportioned income taxes from the state tax prohibition, nor is there even a word in the lengthy legislative history to suggest that Congress meant to carve out such an exception. See *Church of Scientology of California* v. *IRS*, 108 S. Ct. 271, 276 (1987). The *only* specific reference to corporate income taxation is to the contrary. In these circumstances, Congress's silence regarding a special rule for apportioned state taxation of OCS income speaks volumes.

iii. Congress's determination to prohibit state taxation of OCS oil and gas income reflected two important considerations. To begin with, Congress understood, contrary to the states' contention, that the outer Continental Shelf is not analogous to federal lands within a state that are covered by the Mineral Leasing Act. Rather, the OCS was regarded

[34] *Ibid.*

[35] See J. Hellerstein, *State Taxation* ¶ 8.6 at 334 n.120 (1983).

[36] National Tax Ass'n, *Proceedings of the Thirty-Second Annual Conference on Taxation—1939*, at 192 (1940).

as "peculiarly a matter of" federal concern [37] and "uniquely an area of exclusive Federal jurisdiction and control." [38] OCS lands "are wholly outside the boundary of any State," [39] and—as this Court recognized in its decisions in the *California*, *Louisiana*, and *Texas* cases—the "States never had title to this territory." [40] As Senator Cordon explained:

> The difference lies in the fact that the area of the Continental Shelf is not within States; it is an area outside the States.
>
> * * * * *
>
> [W]ith respect to the States which do receive such a percentage of income [under the Mineral Leasing Act], the only basis for it is that those States have reserved from private ownership vast areas of public domain. The Senator's State of Louisiana and all the eastern States, on the other hand, derive the full value from all land and natural resources within their boundaries.[41]

Thus, " '[t]he situation is not comparable to that of federally owned areas within a State * * *.' " [42] In-

[37] S. Rep. No. 411 at 6.

[38] 99 Cong. Rec. at 6963 (remarks of Sen. Cordon).

[39] *Id.* at 10472 (remarks of Sen. Cordon). See also *id.* at 7231 (remarks of Sen. Cordon).

[40] *Id.* at 2499 (remarks of Rep. Celler).

[41] *Id.* at 7254-7255. See also S. Rep. No. 146, 99th Cong., 1st Sess. 267 (1985) (letter from Secretary of the Interior Hodel) (the Mineral Leasing Act "was meant to provide funds to States because of their inability to tax Federal lands within their borders. Since the [OCS] areas are outside State borders, no similar loss of tax revenue occurs").

[42] S. Rep. No. 411 at 6.

stead, the OCSLA was considered to be "unique legislation" that recognized "that the assets obtained from [the OCS] shall be regarded as purely and wholly Federal assets, and that the profits obtained therefrom shall be regarded as profits belonging to the Federal Government and as revenue of the Federal Government." [43]

Moreover, Congress concluded that state taxation of OCS oil and gas would obstruct the paramount federal policies that the OCSLA was designed to foster: *first*, state taxes would diminish federal revenues from OCS leases and hence limit the benefits of the leasing program for the United States Treasury; and *second*, such taxes would impair the national interest in the prompt development of OCS resources.

Representative Keating noted the first concern in connection with his amendment to prohibit state taxes. He explained that state taxes on OCS oil and gas would decrease the net value of the leases and thus reduce the amounts lessees would be willing to pay to the government:

> My concern is for the taxpayers of the United States, for in truth it would be their money we would be generous with, if we leave the present wording in the bill.
>
> The tax imposed by the adjacent States would fall, at least indirectly, on the United States, the landlord of this area, since the terms of any lease entered into would have to be fixed in order

[43] 99 Cong. Rec. at 7252 (remarks of Sen. Holland).

> to permit the lessees a fair return and a proper incentive to develop the area.[44]

The Solicitor General agrees that Congress recognized that state taxation of OCS oil and gas "would necessarily decrease federal revenues" (U.S. *Florida* Am. Br. 15 n.11, citing 99 Cong. Rec. at 2571 (remarks of Rep. Keating)). Thus, as this Court cautioned in *Maryland* v. *Louisiana*, 451 U.S. 725, 752-753 n.26 (1981), "[t]he proper fee or charge for drilling * * * on the OCS is a determination which is *solely* within the province of the Federal Government," and "[p]ermitting the States to exercise such power [of taxation] would *adversely affect the price which the Government could command from private developers in their bid price*" (second emphasis added).

In the same way, state taxation of OCS oil and gas income would, as Representative Keating observed in the foregoing remarks, impede a "fair return" to lessees and interfere with the "proper incentive" for them to develop the OCS. In 43 U.S.C. § 1332(3), Congress declared as a matter of federal policy that the OCS "is a vital national resource reserve" that "should be made available for expeditious * * * development." See also, *e.g.*, H.R. Rep. No. 413, 83d Cong., 1st Sess. 2 (1953) (the "principal purpose" of the OCSLA was to authorize the leasing and development of the OCS, and the "importance and necessity" for the legislation reflected the congressional policy that "the development and operation of [the OCS] are vital to our national economy and security"). State taxes would burden this national policy; as Congress itself recognized with respect to royalties, payments should not be "made so high that companies will not feel like operating the lands."[45]

[44] 99 Cong. Rec. at 2571. Other members of Congress noted that state taxes would "bring about an increased cost in the price of oil and gas" to consumers throughout the country (*id.* at 2527 (remarks of Rep. Madden)), including the United States in its purchases of oil for the national defense (*id.* at 2535 (remarks of Rep. Yates)).

b. *The 1978 OCSLA Amendments*

Congress amended the OCSLA in 1978, primarily to provide for alternative bidding systems for OCS leases. In enacting the 1978 amendments, Congress reiterated and reinforced the fundamental policies of the OCSLA: to enhance the government's revenues from OCS lease payments, and to promote development of the OCS through incentives to lessees.

The 1978 amendments make clear the importance of the government's financial interest in OCS leases. This Court has recognized that "[i]n passing the 1978 Amendments, Congress committed the Government to the goal of obtaining fair market value for

[45] *Id.* at 6965 (remarks of Sen. Martin).

In analogous circumstances in *White Mountain Apache Tribe* v. *Bracker*, *supra*, the Court held that a state could not impose a tax on non-Indian logging companies operating on a federal Indian reservation because such taxation would interfere with the federal "policy of assuring that the profits derived from timber sales will inure to the benefit of the Tribe" and "would undermine the Secretary's ability to make the wide range of detetrminations committed to his authority concerning the setting of fees and rates with respect to the harvesting and sale of tribal timber"; as a result, state taxes would impermissibly "reduc[e] tribal revenues and diminish[] the profitability of the enterprise for potential contractors." 448 U.S. at 149.

OCS oil and gas resources." *Watt* v. *Energy Action Educational Foundation*, 454 U.S. 151, 162 (1981). See 43 U.S.C. § 1344(a)(4) ("[l]easing activities shall be conducted to assure receipt of fair market value for the lands leased and the rights conveyed by the Federal Government"); H.R. Conf. Rep. No. 1474, 95th Cong., 2d Sess. 92 (1978) ("the new bidding alternatives * * * should * * * [p]rovid[e] a fair return to the Federal Government"). The 1978 amendments were specifically intended to " 'secure higher returns to the public Treasury' " (454 U.S. at 167 n.18, quoting H.R. Rep. No. 590, 95th Cong., 1st Sess. 47 (1977)).[46]

This fiscal concern is of particular significance because of the substantial importance of OCS payments to the federal budget. As noted above (see pages 5-6, *supra*), the federal government received more than $80 billion in OCS payments during the period 1954-1985. These payments currently amount to approximately $4 billion annually and have exceeded $10 billion in some years. See Office of Management and Budget, *Budget of the United States Government—Fiscal Year 1988 (Supp.)* 5-171, 6c-20, 6c-42. Indeed, in 1983, Congress stated that "[f]ederal revenues received from outer continental shelf oil and gas exploration and development activities represent one of the largest sources of income to the U.S. Treasury, behind only Internal Revenue Service

[46] Furthermore, by authorizing the Secretary of the Interior to experiment with systems of lease payments based on lessees' net OCS profits (see 454 U.S. at 155 & nn.3, 5), the 1978 amendments give the government a direct interest in the profitability of OCS production (*id.* at 166-167 n.18)—an interest that would be adversely affected by state taxation of OCS oil and gas income.

income taxes." H.R. Rep. No. 206, 98th Cong., 1st Sess. 59 (1983); see also S. Rep. No. 112, 98th Cong., 1st Sess. 13 (1983).

Likewise, the 1978 amendments were intended, as Section 102 states, to make OCS oil and gas resources "available to meet the Nation's energy needs as rapidly as possible" through "expedited exploration and development of the Outer Continental Shelf."[47] The Conference Report "emphasize[d] the need for the expeditious * * * exploration and development of the Outer Continental Shelf," and it stressed the importance of "avoiding unnecessary delays in exploration, development, and production," of "discovering and recovering oil and gas," and of "developing new oil and gas resources in an efficient and timely manner."[48] To that end, the amendments were intended to " 'provid[e] the incentive of a fair profit to the oil companies, which must risk their investment capital,' "[49] and to " 'increase the availability of funds for exploration.' "[50] Congress was well aware of the "vast amounts of capital" necessary to bid on and develop OCS tracts and the "increasing risks of uncertainty" in OCS projects, including "[t]he lack of experience in frontier areas" and the "deeper OCS depths requiring more sophis-

[47] See H.R. Conf. Rep. No. 1474 at 4.

[48] *Id.* at 76, 92. See *Watt* v. *Energy Action Educational Foundation*, 454 U.S. at 164 n.16; *Secretary of Interior* v. *California*, 464 U.S. 312, 336 (1984).

[49] 454 U.S. at 164 n.16, quoting H.R. Rep. No. 590 at 54. See 124 Cong. Rec. 26778 (1978) (remarks of Rep. Murphy).

[50] 454 U.S. at 166 n.18, quoting S. Rep. No. 284, 95th Cong., 1st Sess. 46-47 (1977). See 124 Cong. Rec. at 26778 (remarks of Rep. Murphy).

ticated and expensive equipment and technologies." [51] Thus, "we are now in a period in which investment capital is tight * * * and the risks high." [52]

Congress's affirmation of the OCSLA policy to promote development of the OCS came against the background of the Nation's energy crisis of the 1970s:

> [The 1978 amendments are necessary to] expedite the systematic development of the OCS * * *.
>
> The United States is becoming increasingly dependent on foreign sources of oil. This dependence must be reduced. * * * The basic purpose of [the 1978 amendments] is to promote the swift, orderly and efficient exploitation of our almost untapped domestic oil and gas resources in the Outer Continental Shelf. During the 1980's, oil and gas development on the OCS is likely to be one of the single largest sources of additional domestic energy, and at a lower expense than most alternatives in terms of development and impact costs.[53]

[51] H.R. Rep. No. 590 at 47, 54, 94. See S. Rep. No. 284 at 49 ("Many dollars of investment and much effort separate [proved reserves] from [potential reserves]"); 124 Cong. Rec. at 1629 (remarks of Rep. Murphy) ("[e]ven the larger oil companies * * * [are having] capital formation problems"); *id.* at 1630 (remarks of Rep. Miller) ("massive amounts" of capital are necessary for leasing); *id.* at 1633 (remarks of Rep. Miller) (oil in "the frontier areas * * * is more expensive to develop").

[52] *Id.* at 26778 (remarks of Rep. Murphy).

[53] H.R. Rep. No. 590 at 53. See *id.* at 103 ("offshore production 'can be the largest domestic source of oil and gas between now and the 1990's,'" and "the only substantial new source of domestic oil and gas will be found in the OCS").

Accordingly, OCS development was expected to "provide one of the largest single sources of increased domestic energy" and to "supply this energy at a lower average cost to the U.S. economy than many other alternatives" and "with substantially less harm to the environment than most other sources." [54] Congress viewed "expedited exploration and development of the" OCS as essential "in order to achieve national economic and energy policy goals, assure national security, reduce dependence on foreign sources, and maintain a favorable balance of payments in world trade." [55] In view of these urgent concerns, as Representative Murphy observed in introducing the Conference Report, "[t]he importance of OCS resources to the United States * * * cannot be overstated," and "it is vital that we develop these resources as rapidly as modern technology will safely permit." [56]

In sum, Congress in enacting the OCSLA in 1953 sought to preserve OCS revenues for the federal treasury and to encourage development of the OCS. The state tax prohibition was an integral aspect of the federal program for accomplishing these goals. In the 1978 amendments to the OCSLA, Congress reaffirmed those objectives, which had assumed even greater importance in light of the pressing budgetary and energy needs of the country. Because Iowa's attempt to tax Shell's OCS income is flatly inconsistent with these purposes of the OCSLA, it must give way to the national interest.

[54] S. Rep. No. 284 at 42.

[55] H.R. Conf. Rep. No. 1474 at 4.

[56] 124 Cong. Rec. at 26779.

4. *The OCSLA Prohibition Of State Taxation Is Not Redundant Of The Constitutional Restrictions On State Taxes*

With virtually no reference to the language, history, or policies of the OCSLA, Iowa asserts (Mot. to Dis. 14-17) that the state tax prohibition merely codifies the constitutional proscriptions already embodied in the Due Process and Commerce Clauses against a state's taxation of values that are outside its territorial jurisdiction. That interpretation, however, renders the statutory provision superfluous and largely trivializes Congress's extensive and often contentious debate over the issue of state taxing authority. The Congress that enacted the OCSLA—and the subsequent Congresses that have considered questions of OCS development and national energy policy—certainly thought that the statute did something more than simply incorporate a well-established and indisputable constitutional principle.

Iowa makes no effort to square its pointless reading of the OCSLA with the clear language that Congress employed in Sections 1333(a)(2)(A) and 1333(a)(3): "State taxation laws shall not apply to the outer Continental Shelf," and the OCSLA "shall never be interpreted as a basis for [a state's] claiming any interest in * * * the property and natural resources [of the OCS] or the revenues therefrom." Iowa makes no effort to square its reading with the legislative history of the OCSLA—and especially Senator Long's statements—that Congress intended to prohibit all state taxes on OCS income and activities. And Iowa makes no effort to square its reading with the overriding policies of the OCSLA—to maximize federal revenues and to promote OCS development—which are impaired by any

state tax on OCS income and activities, not just those for which the state constitutionally lacks jurisdiction.

Moreover, Iowa's proffered interpretation, by treating the state tax prohibition as a nullity, is irreconcilable with fundamental rules of statutory construction. It is a "basic axiom" that "courts should construe all legislative enactments to give them some meaning." *Rosado* v. *Wyman*, 397 U.S. 397, 415 (1970). Under this " 'elementary canon of construction,' " courts have the " 'duty to give effect, if possible, to every clause and word of a statute * * *, rather than to emasculate an entire section.' " *South Carolina* v. *Catawba Indian Tribe*, 106 S. Ct. 2039, 2046 n.22 (1986) (citations omitted). This Court should not "lightly" accept Iowa's invitation to "conclude that [the] congressional enactment has no purpose or function." *Mercantile Nat'l Bank* v. *Langdeau*, 371 U.S. 555, 560 (1963).

In the end, the language, history, and policies of the OCSLA convincingly establish that the Act was intended to prohibit state taxation, in *any* form, of OCS oil and gas income. At every turn, Congress rebuffed the states' efforts to reap tax revenues from the OCS. The OCSLA bars "[s]tate taxation laws" without exception, and Congress meant the statute to be a significant additional restriction on the states, not a meaningless repetition of the existing constitutional ban on extraterritorial state taxation. Furthermore, Congress explicitly prohibited state attempts to claim "any interest in" the revenues from OCS oil and gas production, whether based on assertions of jurisdiction or otherwise. The Court should reject Iowa's attempt to convert these important

statutory provisions into useless and expendable redundancies.

5. *At A Minimum, The OCSLA Prohibits State Taxation Of OCS Income Earned From Sales To Third Parties On The Shelf*

For the foregoing reasons, we submit that the OCSLA prohibits Iowa's apportioned tax on any of Shell's OCS oil and gas income. If the Court disagrees with that contention, however, it should construe the Act to bar state taxation of income earned from OCS production that is sold to a third party on the Shelf itself. In the related case of *Shell Oil Co.* v. *Department of Revenue, State of Florida*, appeal pending, No. 86-1593 (filed Mar. 20, 1987), Florida has "concede[d] that any revenues which Shell derives from actual sales consummated on the OCS oil platforms are beyond the reach of Florida's taxing power as limited by section 1333(a)(2) [of the OCSLA]." See Shell *Florida* J.S. App. 1-8. That concession is compelled by the OCSLA.

With respect to OCS oil and gas that is sold on the Shelf, the applicability of the OCSLA state tax prohibition is manifest. The income being taxed consists of nothing but the net value of the resources extracted from the OCS. That production has no geographical nexus to any area but the OCS at the time it is conveyed by the taxpayer-lessee. And all of the events giving rise to the lessee's tax liability for the income earned—the extraction of the oil and gas and the realization of gain through its sale—have occurred within this exclusive federal enclave. In the most literal sense, state taxes have, in contravention of the OCSLA, been "appl[ied] to the outer Continental Shelf" (43 U.S.C. § 1333(a)(2)(A)),

and the state has "claim[ed]" an "interest" in the apportioned "revenues" from OCS activities (43 U.S.C. § 1333(a)(3)).

Moreover, the dual policies underlying the OCSLA —to promote development of the OCS through incentives to lessees, and to enhance the government's revenues from lease payments—are most directly implicated in this situation. To tax the income of an OCS lessee who extracted and sold minerals entirely on the Shelf would impose a direct burden on the profitability of the OCS operation, thereby reducing the lessee's incentive to undertake development and lowering the value of the rights for which lease payments will be made to the government.

Accordingly, as Florida correctly recognizes, the OCSLA requires at a minimum that state taxes exclude from the apportionable income base the earnings attributable to oil and gas that the taxpayer-lessee extracts from the OCS and sells to a third party on the Shelf.

CONCLUSION

The judgment of the Supreme Court of Iowa should be reversed.

Respectfully submitted.

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